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IN THE

Supreme Court of the United States

OCTOBER TERM, ~~1952~~ 1953

No. ~~702~~ 33

IN THE MATTER OF THE FLORIDA EAST COAST RAILWAY CO.,
Debtor,

S. A. LYNCH, S. A. LYNCH CORPORATION, et al.,
Petitioners,

vs.

ATLANTIC COAST LINE RAILROAD CO.,
Respondent.

BRIEF OF THE RESPONDENT, ATLANTIC COAST LINE RAILROAD COMPANY, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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April 14, 1953

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The Record.

The petitioners refer to the record as consisting only of "six volumes numbered I to VI" (p. 2). We presume that the record also includes the unprinted record which was before the Court of Appeals (see respondent's brief in No. 670, p. 4).

JURISDICTION.

The writ is sought under 28 U. S. C. § 1254.

THE QUESTIONS PRESENTED.

The petitioners list four questions.

The first relates to the respective functions of the Interstate Commerce Commission, the District Court and the Court of Appeals in connection with a plan of reorganization under Section 77. In the statement of the questions presented, the first question is subdivided into two parts (2-3), and later the two parts are discussed separately under headings I (p. 9-15) and II (p. 15-17). Much the same subject is involved in the second question presented in No. 670 (see respondent's brief, p. 46-62).

The second question relates to the absolute priority rule, which is discussed at pages 17-21 of the petition.

Questions numbered 3 and 4 are stated (p. 3) but not further discussed. Accordingly, we will make no further reference to them.

STATUTE INVOLVED.

The statute involved is Section 77 of the Bankruptcy Act (11 U. S. C. § 205). The pertinent portion is set forth in the appendix to the petition.

STATEMENT OF THE CASE.

In connection with the petitioners' statement of the case we refer to the respondent's brief in No. 670 (p. 7-25).

As appears from what is said there (p. 10-12), the statement at page 3 of the present petition, that "Substantially all of the affected security holders of the debtor have opposed the enforced sale of their properties on the terms and conditions proposed", is not correct.

As also appears from the respondent's brief in No. 670 (p. 13-14), the division in the Court of Appeals did not relate to any question now presented by the Lynch Interests.

Two of the petitioners' allegations are as follows (p. 4):

> "Petitioners, who have been in this proceeding since 1938, are interested only in fair and equitable treatment for the Refunding bondholders. Their position throughout has been independent of that of either of the two major parties."

But it is indisputable that the petitioners agreed upon and supported the alternative equity plan, which is mentioned in the petition (p. 7) and more fully described in the respondent's brief in No. 670 (p. 20-23; Appendix B, p. iv-vii); an outstanding feature of the alternative equity plan is the provision for *unequal* treatment of the Refunding bondholders and no one who sponsors a plan for unequal treatment is entitled to assert that he is "interested only in fair and equitable treatment". Nor can we accept the statement that the position of the petitioners "has been independent of that of either of the two major parties"; before the District Court in February, 1952 petitioners had an *agreement* with the duPont Trustees and the St. Joe Paper Company—they worked hand-in-hand with them in opposing the Commission's Plan and in seeking a dismissal of the proceeding in order to put through the alternative equity plan.

Referring to the differences between the Present Plan and the Previous Plan, the petition says (p. 6):

> "The principal difference was an increase of $6,000,000 in face amount of securities to be paid

> by Atlantic Coast Line, which was the entire recognition given to an increase of $800,000 in estimated earning power and to an annual credit of $462,000 for unification savings (282 I. C. C. at 158-160)."

This statement is not supported by the record.

The petitioners' comments about the District Judge's opinion and "the defects pointed out by Judge STRUM" (p. 7-8) are referred to below.

ARGUMENT.

I.

THE DECISION BELOW IS CLEARLY CONSISTENT WITH THE DECISIONS OF THIS COURT AS TO THE RESPECTIVE FUNCTIONS OF THE COMMISSION, THE DISTRICT COURT AND THE COURT OF APPEALS.

The petitioners discuss separately "the relative functions of the Commission and District Judge" (p. 9-15) and the respective functions of the Court of Appeals and the District Judge (p. 15-17). The two subjects can well be treated as two aspects of a single subject, as they are in the petitioners' statement of the questions presented (p. 2-3).

The petitioners say that the decision below would reduce the position of the District Judge "to that of little better than a rubber stamp, except for constitutional questions" (p. 9). It would be more correct to say that on the petitioners' theory a single Judge holding the District Court in a Section 77 proceeding should prevail over both the Commission and the Court of Appeals and be permitted to block a plan which both had approved.

The petitioners say (p. 11):

> "Thus the majority below treated the Commission's action as conclusive because supported by some evidence. It disregarded completely the necessity for compliance with legal and statutory standards. It ignored the defects pointed out in detail by the District Judge."

To establish that there is no basis for these assertions it is necessary only to show what the Commission, Judge STRUM and the Court of Appeals did.

The Commission's Reports and Findings.

The Plan rests upon the Commission's reports and findings. Whatever the deficiencies in the Commission's Third and Fourth Supplemental Reports, which were criticized on the prior appeal (179 F. 2d 543), the Court of Appeals expressed unqualified approval of the Fifth and Sixth Supplemental Reports, which support the present Plan (II, 727-728;* 201 F. 2d 329-330).

Except as to the absolute priority rule, which is discussed below, the petitioners make no effort to show that any of the Commission's findings, whether of fact or of law, was erroneous.

Judge Strum's Opinion.

The petitioners say that Judge STRUM wrote "an extensive opinion which fully and carefully analyzed the evidence, the Commission's proposals and the objections thereto" (p. 7) and they refer to "his elaborate analysis of the plan and his specific rulings thereon" (p. 11) as well as to "the detailed supporting reasons given by the District Judge" (*id.*).

To refute the assertion that Judge STRUM's opinion *fully* analyzed the evidence it is sufficient to refer to pages 53-57 of the respondent's brief in No. 670. Judge STRUM made no reference at all to any of the four forecasts of the normal income of the Florida East Coast which were made by or on behalf of the parties to the proceedings, although one of the four was made by the Judge's own officers, the Trustees, and another was made by a witness for the petitioners. The Judge referred not at all to the

* In this and similar citations the Roman numerals refer to the volume of the printed record and the Arabic numbers to the page.

Commission's forecast of the earnings of the Atlantic Coast Line. As to the "fair market value" of the securities which would be issued under the respective plans, he did not mention the evidence before the Commission, the Commission's findings or the evidence introduced in the District Court.

In considering whether Judge STRUM's "detailed supporting reasons" were correct, it should be enough to say that the majority of the Court of Appeals found them to be "without support in law or in fact" (II, 729-730; 201 F. 2d 330). The minority of the Court of Appeals expressed no disagreement. Judge STRUM has been administering the affairs of the Florida East Coast for 21 years and he is now a Circuit Judge. It is not to be supposed that other members of the Court of Appeals would have come to such a conclusion about his opinion unless they were convinced that a proper discharge of their judicial duties left them no alternative.

The petitioners make no real effort to show that Judge STRUM was right, and the Court of Appeals wrong, on any point except the absolute priority rule, which we discuss later.* Like the petitioners in No. 670, they seem to hope that the adjectives which they use in characterizing Judge STRUM's opinion will carry more weight than the conclusion of the Court of Appeals that Judge STRUM's findings were "without support in law or in fact".

The Majority Opinion in the Court of Appeals.

Chief Judge HUTCHESON's opinion recites that the Court of Appeals reviewed the record before it (II, 727-728; 201 F. 2d 329-330).

The opinion says that the Commission's findings as

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*As noted below, although the petitioners contend that Judge STRUM was right in his conclusion that the Plan violates the absolute priority rule, there is a radical difference between the petitioners' conception of the supposed violation and Judge STRUM's conception.

to the public interest are abundantly supported by the evidence (II, 727; 201 F. 2d 329). Evidently the Court thought, quite rightly, that there was no possible interpretation of Section 77 which would authorize any Court to exercise or express a judgment—as Judge STRUM expressed his judgment—on public interest matters.

As to valuation and fairness of the Plan, the opinion went much further. In addition to saying that the Commission's "finding that the plan was fair and equitable finds full support in the evidence", the opinion said (II, 728; 201 F. 2d 329-330):

> "Indeed, an examination of all the testimony now available touching on and dealing with the valuations which under the statute it was for the commission to make, demonstrates, we think, beyond any peradventure that the commission's findings and estimates of the respective future earnings of East Coast and Coast Line and of the present and future values of the securities to be given in exchange for each other was most favorable to the bondholders of East Coast.
>
> "The same careful examination shows that but for the fact, which apparently dominates and controls most of the bondholders in this controversy, that they are primarily concerned not with obtaining value received for their securities but with a conversion of their bonds into a title to the East Coast properties, so that they will own and manage the railroad, all of them would be bound to agree that what they will receive for their bonds under the plan will be of a value equal to, or more than, that of their bonds."

In these two short paragraphs Chief Judge HUTCHESON went to the heart of the case:

He dealt with the *respective* forecasts of the future earnings of the two railroads. Judge STRUM had discussed only the prospective earnings of the Florida East

Coast and what he had said on that subject cannot be supported (see respondent's brief in No. 670, p. 53-54).

Second, Judge HUTCHESON's opinion dealt with "the present and future values of the securities to be given in exchange for each other". Judge STRUM had said that it was immaterial what the "ostensible value" of the securities issued under the Plan might be and he condemned all Atlantic Coast Line securities as "of fluctuating and debatable value" (see respondent's brief in No. 670, p. 55-57).

Third, the Chief Judge put his finger on the reason for the opposition to the Plan—the desire of the duPont Trustees and the St. Joe Paper Company for control.

The omission from Judge Hutcheson's opinion of a detailed discussion of all of Judge Strum's stated reasons for disapproving the Plan.

The petitioners criticize Judge HUTCHESON's opinion because, as they say (p. 11):

> "Despite these detailed supporting reasons given by the District Judge, the majority opinion below fails to refer to a single one of them."

We have just noted that Judge HUTCHESON did mention the *principal subjects*, which Judge STRUM discussed, as well as some which he should have discussed. The petitioners' real criticism is that Judge HUTCHESON did not take Judge STRUM's opinion up and show in detail, as the appellants had done in the Court of Appeals, that not a single one of the "detailed supporting reasons" was valid.

In our brief in No. 670 we referred to a similar criticism (p. 52-53). Any such dissection by Judge HUTCHESON of Judge STRUM's opinion would have necessitated detailed comments on practically all of the Commission's findings and the evidence supporting them. It would be preposterous to suggest that Judge HUTCHESON was required to assume any such burden.

The petitioners are among those who induced Judge STRUM to find in March, 1952, that there had been "undue delay in a reasonably expeditious reorganization of the debtor" (I, 169). Yet they seem to insist that Judge HUTCHESON should have spent a large part of the year 1953 working on an opinion pointing out in detail all of the errors in, and omissions from, Judge STRUM's opinion.

The contention that the Court of Appeals reversed itself.

The petitioners' contention that the Court of Appeals reversed its position (p. 9-11) is based on their argument that Judge HUTCHESON's opinion "disregarded completely the necessity for compliance with legal and statutory standards" (p. 11). That is a wholly untenable interpretation of Judge HUTCHESON's opinion.

Actually what Chief Judge HUTCHESON's two opinions show is that he was not satisfied that in approving the 1948 plan the Commission had complied with legal standards but he was satisfied that in approving the present Plan the Commission had complied with legal standards.

The Authorities Cited by the Petitioners.

The decisions of this Court which petitioners cite at pages 12-13 are apparently brought forth to support the proposition that it is the function of the District Court to consider whether the Commission has acted in accordance with the statutory standards. There is no dispute on that point.

In addition, the petitioners apparently regard *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* (1943) 318 U. S. 523, 564 and *Comstock* v. *Group of Institutional Investors* (1948) 335 U. S. 211, 227-228 as establishing that the District Court in a Section 77 proceeding has an indistinct but all-pervading discretionary power with respect to a plan of reorganization.

In the *Milwaukee* case the District Court approved a plan which had been certified to it by the Commission. The Court of Appeals had reversed the District Court on grounds which this Court found to be erroneous. This Court then had to consider the effect of the consecutive, harmonious decisions of the Commission and the District Court.

In the *Comstock* case the point in connection with which the Court used the word "discretion" related to whether or not the District Court might consider objections to a plan which had not been presented to the Commission. In that connection the Court spoke of "the broad responsibility laid upon the Court for the equity and fairness of the plan as a whole". Manifestly, any such "broad responsibility" and "discretion" did not extend to disapproving, on grounds that are "without support in law or in fact", a plan certified by the Commission.

In this case the Judge holding the District Court disagreed with the Commission. The disagreement was so far-reaching that the Judge undertook to dismiss the Section 77 proceeding on the ground that there was a hopeless impasse. The Court of Appeals reviewed the record, and, after studying voluminous briefs and listening to an extended argument, the Court decided that the Judge holding the District Court was clearly wrong on every material point of law or fact or mixed law and fact.

The petitioners say that "the court below assumed to itself the functions of the District Judge" (p. 16). That is true only in the sense that, having ascertained that the District Judge's findings were "without support in law or in fact", the Court of Appeals proceeded to do what the District Judge should have done.

The petitioners do not complain that the Court of Appeals should have sent the case back to the District Court for reconsideration, rather than directing the District Court to approve the Plan. Their complaint seems

to be that the Court of Appeals should have taken Judge STRAUM's opinion on faith and should not have considered the case on its merits.

The Petitioners' Basic Misconception.

The petitioners' basic idea is the same as that propounded by the petitioners in No. 670 in their argument on their second question (see respondent's brief in No. 670, p. 46-62).

The thought is that the Judge holding the District Court should be dominant. He would achieve dominance over the Commission because he could block any plan which the Commission might approve and could castigate the Commission in formal judicial opinions if it failed to approve such a plan as he might think suitable. And he would be unfettered by any supervision by the Court of Appeals or by this Court.

Section 77 does not contemplate that a District Judge shall enjoy such a dominance in connection with railroad reorganization plans.

II.

THERE IS NO QUESTION INVOLVING THE ABSOLUTE PRIORITY RULE.

The petitioners' second question reads (p. 3):

> "2. Does the rule of absolute priority permit the enforced sale of a debtor's property for securities of a third party having a value substantially less than the value of the property required to be sold?"

The question assumes that under the plan there would be a sale for securities "having a value substantially less than the value of the property sold". It is obvious that such a sale would be illegal. It is equally obvious that the absolute priority rule would not be the basis of the illegality and has nothing to do with the subject.

In support of the proposition that the Plan provides for a sale for less than the value of the property sold the petitioners quote from Commissioner Mahaffie's dissent (p. 18) and they cite 282 I. C. C. at 162-163 as authority for the statement that "the debtor has a value of $46,500,000, for which Atlantic Coast Line would pay a consideration worth only $43,694,000" (p. 19, 20).

As this Court said in *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* (1943) 318 U. S. 523, 540, Justice BRANDEIS pointed out many years ago that "value is a word of many meanings". The $43,694,000 and the $46,500,000 represent two different kinds of "value".

The $43,694,000 represents the *fair market value*, as determined by the Commission based on conditions prevailing on May 25, 1951 and on the Commission's forecasts, of the securities (plus the cash) which would be provided by Atlantic Coast Line under Section IX of the Plan (282 I. C. C. 162-163; see also 282 I. C. C. 154-158).

The $46,500,000 is the sum of the *face values* of the securities and cash, the Atlantic Coast Line Railroad Company no par value Common Stock being treated as if it had a par value of $100 per share.*

Actually the $46,500,000 is not mentioned at 282 I. C. C. 162-163, but it represents the total in the last column in the table at page 162 ($51,814,086) less the amount of the equipment obligations which would be assumed ($5,314,086), and it is mentioned elsewhere in the Fifth Supplemental Report. It represents the capitalization—that is, the sum of the amounts which would be entered on the books as liabilities, including capital stock liabilities.

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* At the time when the Atlantic Coast Line proposed its first plan in 1945, the Common Stock of the Atlantic Coast Line had a $100 par value. In 1946 the Stock was changed to no par value (see Exhibit No. 298 in the Interstate Commerce Commission Record referred to in Volume I at page 183).

Of course, if the Commission had said that what the Atlantic Coast Line would receive under the Plan was worth 46,500,000 dollars and that what the Atlantic Coast Line would pay for what it would receive would be worth only 43,694,000 dollars, as the petitioners imply, the Plan could not be sustained. But the Commission did not value the Debtor's properties in dollars. In the Sixth Supplemental Report it said (282 I. C. C. 199):

> "While we made findings, as requested, of the market values of the securities composing part of the compensation approved, as well as of the securities which we found the debtor would be justified in issuing under a hypothetical plan for an internal reorganization, our initial and basic determination of the compensation to be paid by the Coast Line, as reflecting the value of the debtor's properties and the other intangible factors involved, was in Coast Line securities. Such a determination, in our opinion, more nearly insures the debtor's creditors receiving the equitable or economic equivalent of the rights surrendered as required by the decisions of the courts. See *Ecker* v. *Western Pac. R. Corp.*, 318 U. S. 448; *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523; and *Schwabacher* v. *United States*, 334 U. S. 182."[1]

The part of Commissioner Mahaffie's dissent which the petitioners quote (p. 18) actually related to the Previous Plan, approved in 1948, not to the present Plan (282 I. C. C. 189). However, Commissioner Mahaffie apparently thought that both Plans were vulnerable on the ground on which the petitioners rely. Not a single Judge agreed with him in condemning the present Plan on that ground.

* * * * *

While the petitioners say that the "District Court reached an equally clear conclusion" (p. 18), the proposi-

[1] In *Western Pacific* see 318 U. S. p. 472 and in *Milwaukee* see 318 U. S. p. 565-566.

tion announced by Judge STRUM is completely different from that relied upon by the petitioners. Judge STRUM did not base his ruling, that there was a violation of the absolute priority rule, on any disparity between the value of the property which would be transferred to the Atlantic Coast Line and the value of what the Florida East Coast creditors would receive in exchange therefor. Judge STRUM ruled flatly that the Atlantic Coast Line could not acquire the property for less than the mortgage debt, which is over $80,000,000, including interest. Everything that Judge STRUM said is contained in two sentences, which are quoted in full in the petitioners' brief (p. 18; I, 156-157; 103 F. Supp. 842, footnote omitted):

> "11. The Coast Line, as an unsecured creditor, may not participate in the debtor's mortgaged assets which are less in value than the mortgage debt, unless the debt be paid in full, either in cash or in new securities of equal worth and having the same priority as the old securities to be displaced. Yet the effect of the fourth plan is to divest the 5% bondholders of their present equitable ownership of the mortgaged property and vest it in the Coast Line free of the mortgage lien, for a consideration less than the mortgage debt."

Under the Plan the Coast Line would not "participate in the debtors' mortgaged assets". It would take over the mortgaged assets by exchanging therefor cash and securities which have been determined to be the equitable equivalent of what it would receive.

As an unsecured creditor the Coast Line will "participate" in the unmortgaged assets (282 I. C. C. 176-181, 223-224). An "objection obviously would not run to a participation by junior creditors in unmortgaged assets". *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* (1943) 318 U. S. 523, 569, footnote 13.

However, Judge STRUM's erroneous ruling has no relationship to the petitioners' question No. 2, since Judge STRUM said nothing about a "sale of a debtor's property for securities of a third party having a value substantially less than *the value of the property required to be sold*" (p. 3). He spoke only of the securities having a value substantially less than the mortgage debt.

CONCLUSION.

The petition should be denied.

Dated, April 14, 1953

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